

# Press Release



**R/16**

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## **BRITAIN NEEDS REWIRING TO THE TUNE OF £32 BILLION**

- **Britain needs to be rewired in a smarter way to secure sustainable energy supplies for consumers**
- **Vital investment in pipes and wires must increase by 75 per cent in the next ten years to meet this challenge**
- **The new "RIIO model," used to set network prices, will deliver the benefits of a green economy while keeping costs as low as possible for consumers**

The unprecedented challenges of making the transition to a low carbon economy and securing supplies as efficiently as possible has led Ofgem to introduce the biggest change to the regulatory framework for 20 years. Ofgem's new performance-based model, RIIO, seeks to ensure consumers get the necessary investment in Britain's pipes and wires for a fair price.

Ofgem estimates over **£200 billion** needs to be spent in the next 10 years to secure supplies for consumers and to move to a low carbon economy. Of this, around **£32 billion** will need to be spent on pipes and wires against an industry worth **£43 billion** today, an increase in value of **75 per cent** – and a doubling of the rate of investment from the previous 20 years.

New sources of generation, whether large-scale wind, gas or nuclear plants or small-scale renewables and home-based microgeneration, will require not only a step change in investment, but smarter networks to make sure Britain is rewired to meet these more complex challenges. Moves towards electrification of transport and heat will further increase the need for smart grids.

In order to attract efficient investment, Ofgem's new performance based RIIO model for price controls rewards companies that innovate and run their networks to better meet the needs of consumers and network users. It does this by setting longer eight-year price controls, offering incentives focused on delivering results, and expanding the **£500 million** Low Carbon Network Fund to encourage the growth of smart grids.

Ofgem estimates the RIIO model could cut the cost of investment to consumers by **£1 billion** compared to the previous regulatory framework in the next ten years.

Ofgem's Chief Executive, Alistair Buchanan, said: "**£32 billion** of the **£200 billion** investment challenge Ofgem has identified falls to the regulated energy networks and is within our statutory remit. That is why Ofgem's new performance regulation model, RIIO, will ensure we attract this investment, but at a fair price for consumers.

"The RIIO model will ensure that efficiency and innovation are hard-wired into the network companies. This means the benefits of the green economy, like more skilled jobs delivering

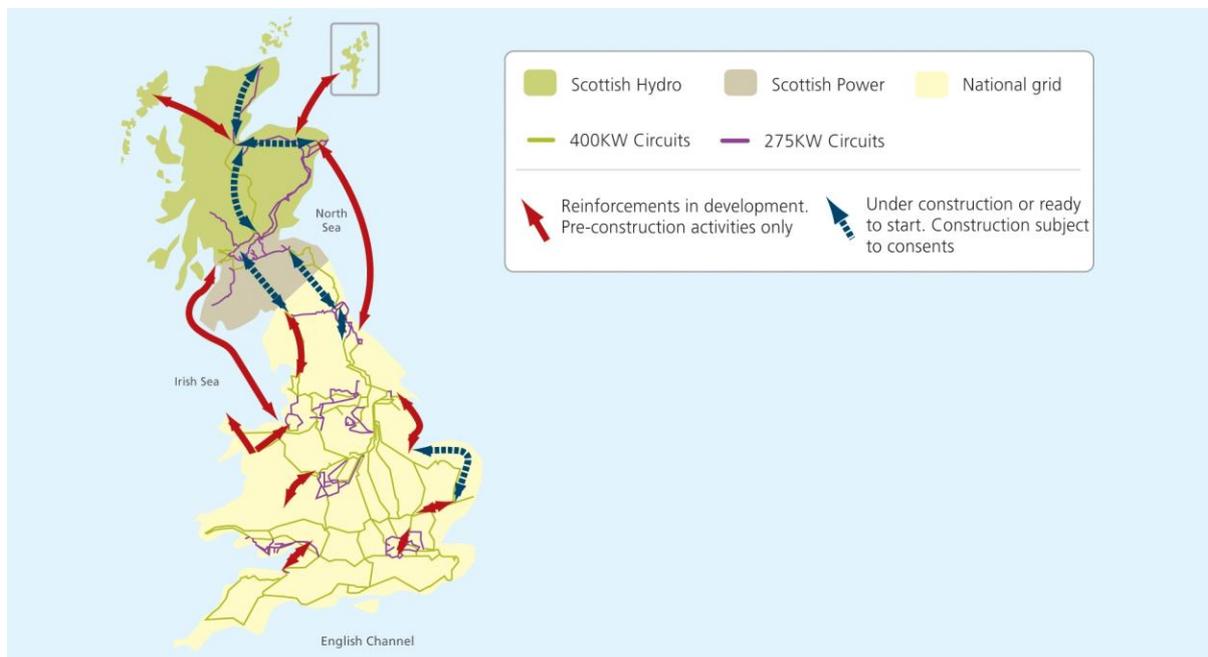
smarter networks to allow householders to run solar energy and other types of microgeneration, will be delivered. However there will be no gold plating of the networks at customers' expense.

"RIIO also gives consumers and network users a bigger voice in what they want network companies to deliver and then rewards companies that take the initiative and deliver this efficiently, while financially penalising laggards and subjecting them to closer regulatory scrutiny."

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## Notes to Editors

### 1. Re-wiring Britain



The map above shows some of the major high-voltage grid connections planned for Britain. In addition to this, major investment will be needed in electricity distribution and for Britain's gas network.

### 2. What will RIIO deliver for consumers?

The aim of RIIO is to ensure that consumers continue to benefit from modern reliable energy networks and that the investment to deliver a sustainable energy sector is delivered as cost effectively as possible. Key benefits for consumers include:

- **A greater focus on the delivery of outputs.** Network companies will have their performance measured against how well they deliver customer satisfaction, service reliability and safety. This would include standards to measure the frequency of power cuts and how quickly supplies were restored.
- **Bigger voice for consumers and network users.** Consumers and network users will have a bigger voice in deciding what results companies should deliver during the price control.
- **Strong focus on efficiency.** Network companies will be permitted to retain a portion of any efficiency gains that they make but will face an equivalent

proportion of any cost overruns that they incur. Poorly performing companies will also face more intrusive regulation than efficient, well-run firms.

- **More focus on innovation.** Firms will face incentives to encourage them to find new and efficient ways of delivering services for consumers and network users. For example, better use of the existing networks could reduce the costs of building new wires and pipes. The current £500 million Low Carbon Networks Fund will be expanded to cover all gas and electricity regulated networks.
- **Competitive tendering for large scale projects.** This could deliver benefits for consumers in the form of new and innovative approaches to delivery or the achievement of significant efficiency benefits.
- **Long-term planning.** Lengthening price controls from five to eight years will provide more stability and help firms invest efficiently to keep costs low.

### 3. Why Britain needs rewiring

- **Connecting new forms of generation** – offshore and onshore windfarms and new nuclear power stations will all need connecting. Much of the renewable generation in Scotland and the Islands or for offshore and onshore windfarms is located in remote locations that will require a radical expansion of the high voltage transmission network, not only to connect the generation but to transport it via sub-sea cables from Scotland to the population centres in England (see map in note 1).
- **Smarter networks** – generation will no longer just flow from large power stations to homes and businesses, as household microgeneration, i.e. solar panels, small scale CHP and renewables, will all deliver electricity throughout the network. This will require much smarter networks to manage this increasing complexity. Also, large-scale renewable generation will make managing the network more complex due to the intermittent nature of wind power.
- **Increased demand** – electrification of heat and transport will bring an increase in demand for electricity and will change how and when consumers use energy, for example, charging electric cars overnight. Smart meters will give consumers the option to shift some of their electricity use to off peak hours.
- **Replacing aging networks** – much of the current electricity networks was built in the 50s and 60s and needs replacing.

### 4. RPI-X: did well for consumers

Ofgem has used the RPI-X model for the last twenty year to control prices and that basic cost control approach worked well - network prices are down 50 per cent on 1990 and an acceptable level of investment of over £35 billion of investment was delivered - but now Britain faces a unprecedented investment hurdle not only to replace infrastructure which is coming to the end of its economic life, but to re-wire Britain so it can meet the complex challenges of delivering a low carbon economy. This will not only require a doubling of the rate of investment but a much more innovative and proactive approach by network companies to meeting the needs of their consumers and network users.

### 5. RIIO model

RIIO stands for **Revenue= Incentives+ Innovation+ Outputs**. Key features of the RIIO model include:

- lengthening price controls from five to eight years which will provide more stability
- much greater say for network customers in setting out what network companies need to deliver, i.e. renewable developers might want faster connections
- fast track price controls will be introduced for companies who innovate, deliver good service and produce well-evidenced plans setting out how they will invest efficiently for the future
- poorly performing companies will face much more intrusive regulation and lower returns
- stronger incentive regime to encourage more efficient investment and innovation
- adding the option of giving new network companies a greater role in delivering certain large-scale projects where this does not delay delivery. This could open up new sources of finance and encourage innovation, and
- expansion of the current Low Carbon Networks Fund to encourage greater innovation across gas and electricity networks.

## **6. When will Ofgem's proposals be introduced?**

Ofgem's new regulatory framework has been developed through an extensive two-year process of consultation with stakeholders. The framework will first be applied for the next two price controls, for gas distribution and gas and electricity transmission. The work on these controls starts now and final decisions are expected until the end of 2012. The controls themselves are not due to start until 2013 and all proposals relating to these controls will be subjected to the usual open and transparent price control process. Electricity distribution price controls are not up for renewal until 2015.

## **7. Ofgem**

Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority, the regulator of the gas and electricity industries in Great Britain. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002, the Energy Act 2004 as well as arising from directly effective European Community legislation.

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